STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MICHAEL LENHARD	:	DECISION
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Period January 1, 1977 through December 31, 1982.	:	

Petitioner, Michael Lenhard, 36 Ivory Way, Henrietta, New York 14467, filed an exception to the determination of the Administrative Law Judge issued on October 20, 1988 with respect to his petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the Period January 1, 1977 through December 31, 1982 (File No. 801335). Petitioner appeared by Lacy, Katzen, Ryen & Mittleman (Don H. Twietmeyer, Esq. and Reid A. Holter, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in response to the petitioner's exception and brief. Oral argument at the request of the petitioner was heard on May 23, 1989.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether a pending bankruptcy proceeding involving FML Supply, Inc. prevents the Division of Tax Appeals from adjudicating the personal liability asserted against petitioner pursuant to section 685(g).

II. Whether petitioner is liable for the penalty asserted against him pursuant to Tax Law section 685(g) with respect to New York State withholding taxes due from FML Supply, Inc.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and the relevant facts are stated below, except that we modify finding of fact "2". We also find additional facts as indicated below.

On May 21, 1984, the Division of Taxation issued a Notice of Deficiency to petitioner, Michael Lenhard, asserting a deficiency of personal incometax for the years 1977, 1981 and 1982 in the amount of $34,202.22. The Statement of Deficiency, which was also issued on May 21, 1984, explained that the Division was asserting the deficiency against petitioner as a person required to collect, truthfully account for and pay over the taxes withheld from the wages of the employees of FML Supply, Inc. d/b/a Lenhard's Roto Rooter ("FML"). The Statement of Deficiency listed the withholding tax periods and the respective amounts asserted to be due as follows:

Withholding Tax Period	Amount
January 1, 1977 through December 1, 1977	$ 4,235.12
January 1, 1981 through September 30, 1981	12,717.48
January 1, 1982 through December 31, 1982	17,249.62
	$34,202.22

We modify finding of fact "2" of the Administrative Law Judge's determination to read as follows:

> The amount of tax asserted for the year 1977 was premised upon information provided by FML Supply, Inc. Similarly, the amount of tax asserted for the years 1981 and 1982 was based upon the reported, but unpaid, withholding tax liability of FML.[1]

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[1] The Administrative Law Judge's finding of fact "2" read as follows:
"2. The amount of tax asserted for the year 1977 was premised upon information provided by petitioner. Similarly, the amount of tax asserted for the years 1981 and 1982 was based upon the reported, but unpaid withholding tax liability of FML."

We have modified this finding of fact to show that the amount of tax asserted for the year 1977 was computed from the information provided by FML Supply, Inc., and not the petitioner.

FML was a corporation which provided plumbing service, sewer and drain cleaning, backhoe work and drilling for water service. Prior to 1977, the officers of FML were petitioner's mother, who held the office of president, and petitioner's father, who served as business manager.

In 1977, petitioner became the president of FML. As president, petitioner supervised the field workers, spoke with customers on the telephone and negotiated contracts. Although he did not exercise the authority, petitioner had the right as president to hire and fire employees. Similarly, although he did not frequently exercise the authority, petitioner had the authority to sign checks on behalf of the corporation.

After petitioner became president, the financial affairs of FML continued to be handled by petitioner's father, Kenneth B. Lenhard.

Mr. Kenneth Lenhard was responsible for filing the tax returns and remitting the tax due.

In July 1981, petitioner's father decided that petitioner would do a better job of handling the tax matters of FML and, therefore, he turned that responsibility over to petitioner. Thereafter, petitioner visited the local

office of the Department of Taxation and Finance in order to resolve FML's debt.

Petitioner was informed at the District Office that FML owed a substantial sum of money and that it would be closed down unless FML began making payments of $1,000.00 a week. Thereafter, FML made an initial payment of $5,000.00 and commenced payments of $1,000.00 a week. These payments were made directly to the local District Office at the insistence of that office.

We find as an additional fact that the record before us is unclear as to what taxes and dollar amounts petitioner was informed FML owed before he started making payments to the District Office in July, 1981.

We also find, to more accurately reflect the record relating to payments made during 1981, that the $5,000.00 initial payment was made on July 23, 1981, and further during the

months of August and September 198l, five (5) payments of $1,500.00 each were made with an additional $6,000.00 payment on October 22, 1981. For the remaining ten (10) weeks of 1981, payments of $l,000.00 were made each week. The record also shows 1981 payments to the District Office by FML for corporation tax ($250.00) as well as three (3) sales tax payments totalling $6,032.04. Total payments made directly to the District Office by FML in 1981 amounted to $34,782.04.

On December 7, 1981, petitioner entered into a Deferred Payment Agreement in the amount of $59,007.57 with respect to the payment of certain outstanding sales tax liabilities. The second page of the agreement contained conditions which provided, in part, as follows:

> "Failure to meet the following conditions will lead to default and further enforcement action.
>
> 1. Current returns must be filed and paid on a timely basis to the Tax Compliance Bureau, P.O. Box 5046, Albany, NY 12205."

We find the following additional facts:

1) The Tax Compliance Agent who was assigned the FML case when the petitioner first went to the Rochester District Office (July 1981) testified that "we only take delinquent payments here" (Tr. p. 144), and "When I made out the Deferred Payment Agreement, it was taken exactly off the computer printout. So at that point of time he knew what he owed." (Tr. p. 169). When asked whether under any circumstances would the District Office take payments for current withholding or current sales taxes, the agent answered, "No. He's instructed, it says on his agreement, he's to pay--" [end of statement] (Tr. p. 145). This Agent was only involved with this case between July 1981 and November 1981 (Tr. p. 145).

2) Notwithstanding the wording on the Deferred Payment Agreement and the testimony of the Tax Compliance Agent referred to above, another Tax Compliance Agent, also from the Rochester District Office testified, "The Department's procedure is that all current taxes must be timely filed and full paid or else the Deferred Payment Agreement would be defaulted, and most often we ask for the Taxpayer to submit the current returns and payments to us, but that's not mandatory" (Tr. p. 91) (emphasis added). This same Agent testified (Tr. p. 83) that petitioner's

checks (Exhibits 1 through 3 for tax years July 1981-August 1983) were not mailed to Albany, New York, but were instead received at the District Office. We also add that the checks referred to include sales tax, withholding tax, and corporation tax payments.

3) FML made $1,000.00 payments to the District Office in 1982 totaling $32,000.00 as well as payments of $4,257.75 specifically for sales taxes. For the year 1983, the payments to the District Office amounted to $31,990.24.

Petitioner continued making monthly payments until August 1983 when discussions with personnel in the Division led petitioner to believe that although he had paid over $100,000.00 he still owed over $100,000.00 for various taxes including sales tax and withholding tax. Petitioner then demanded an explanation of where the money was applied. When he did not receive an explanation which met his satisfaction, he stopped making payments according to the payment agreement and started paying only current liabilities.

We find as an additional fact that FML paid $1,990.24 on September 29, 1983 directly to the District Office for the sales tax quarter ending August 1983 as well as four (4) checks totalling $3,039.25 directly to Albany (Dept. Exhibit J & Pet. Exhibit 6) for withholding taxes for periods between November 6, 1983 and January 15, 1984.

An agent of the Department threatened to close down FML when the payments pursuant to the Deferred Payment Agreement ceased. Consequently, FML filed a petition under Chapter 11 of the Bankruptcy Law in order to protect itself. The Notice of Deficiency which is the subject of this proceeding was issued after the filing of the bankruptcy petition.

Periodically, petitioner received documentation from the Division which reported an amount due. On occasion, this documentation did not show any liability for 1977. Similarly, although the Division asserted a claim against FML in the bankruptcy proceeding, no claim was asserted for the year 1977.

During the period 1977 through July 1981, petitioner was aware that FML had debts but he was not involved in paying them. Moreover, petitioner was not aware during this period of the extent of FML's tax deficiency.

On October 30, 1981, November 5, 1981, November 12, 1981, November 19, 1981 and November 24, 1981, bank checks were drafted designating payment of withholding tax. The checks, which total $5,000.00, were applied to outstanding sales tax assessments.

In the course of the hearing, the Division offered a computer printout which disclosed a number of related assessments issued against FML. One portion of the computer printout shows that, with respect to a particular assessment, the amount of tax due for the period January 1, 1983 through September 30, 1983 was $11,849.45.

At some juncture, petitioner became a stockholder of FML. At the hearing, petitioner was uncertain when he first acquired the stock.

The Division conceded at hearing that it had failed to reduce the asserted deficiency by a payment FML had made in satisfaction of a portion of its withholding tax liability for 1981. This payment was in the amount of $3,330.46.

OPINION

The Administrative Law Judge determined that, starting in July 1981, petitioner was a "person" within the meaning of Tax Law section 685(n) required to collect, truthfully account for and pay over withholding taxes (a "responsible officer") and that petitioner's actions were "willful" within the meaning of Tax Law section 685(g) and that the penalty prescribed by that section should be imposed on petitioner, i.e., a penalty equal to 100 percent of the tax due.

The Administrative Law Judge further determined that it was proper for the Division to issue a Notice of Deficiency to petitioner even though FML had a pending petition for bankruptcy.

On exception, petitioner concedes his status as a responsible officer, starting in July of 1981, but argues that he is not liable for the penalty asserted against him pursuant to Tax Law section 685(g) with respect to New York State withholding taxes due from FML Supply, Inc. Petitioner asserts that he acted responsibly at all times and contends there was no willful failure on his part to avoid paying the withholding taxes at issue herein. Petitioner further takes

exception to the bankruptcy issue by asserting that his liability cannot be determined until the actual taxes due are settled as to the amount owed.

The Division, in response to the exception, argues that petitioner's claim is inconsistent with the terms of the Deferred Payment Agreement, the Division's policies and procedures, and the evidence is clear that there was no understanding between the Division and petitioner that the thousand dollar weekly payments made to the Division were to be applied in part to FML's current withholding tax liabilities. Thus, petitioner's failure was willful.

We deal first with the issue of whether the bankruptcy proceeding precludes the assertion of personal liability against petitioner pursuant to section 685(g). We affirm the determination of the Administrative Law Judge on the bankruptcy issue.

The statutory basis for the deficiency asserted against petitioner is subdivision (g) of section 685 of the Tax Law which imposes personal liability in the form of a penalty on any person within the corporate structure who is required and fails to pay over withholding taxes to the Division. This penalty is "separate and independent" from any withholding tax liability due from the corporate employer (Matter of Yellin v. New York State Tax Commn., 81 AD2d 196). Therefore, the pending bankruptcy petition of FML has no bearing whatsoever on the issue of petitioner's personal liability as a responsible corporate officer of FML.

We next address the determination of the Administrative Law Judge on the question of willfulness, and whether the actions of the petitioner were willful within the meaning of section 685(g). We believe it will be helpful to first outline the relevant statutory provisions for withholding of personal income taxes and the underlying purposes and principles for the responsibility and liability for such withholding.

Section 671 of the Tax Law fixes the responsibility on employers to deduct from wages paid to employees "[A] tax computed in such manner as to result, so far as practicable, in withholding from the employee's wages during each calendar year an amount substantially equivalent to the tax reasonably estimated to be due under this article (22) resulting from the

inclusion in the employee's New York adjusted gross income or New York source income of his wages received during such calendar year."

Tax Law section 673 provides that any amount of tax actually deducted and withheld shall be deemed to have been paid to the Tax Commission on behalf of the person from whom withheld and such person shall be credited with having paid that amount of tax for the tax year. In effect, the section provides a credit to an employee, regardless of whether the employer turns the funds over to the State.

Tax Law section 674 prescribes the general requirement for employers to file a withholding return and to pay over to the Commissioner of Taxation or a depository designated by the Commissioner, the taxes required to be deducted and withheld. The section prescribes various filing periods, depending on the amount required to be deducted.

Tax Law section 675 fixes the employer's liability for withheld taxes and provides that any amount of tax actually deducted and withheld shall be held to be a special fund in trust for the State.

Where an employer fails to deduct and withhold tax and thereafter the tax against which such tax may be credited is paid, Tax Law section 676 provides that the tax to be deducted and withheld shall not be collected from the employer, but the employer remains liable for any penalties, interest, or additions to the tax otherwise applicable for failure to deduct and withhold.

Tax Law section 681 prescribes the authority for the Commissioner of Taxation and Finance to examine returns and determine the proper amount of tax due; and where no return has been filed to estimate the tax due.

In summary, the above provisions require employers to withhold State income taxes from employee wages and to hold such taxes in trust for the State. Since employees are entitled to a credit (or refund) based on the taxes deducted from their wages, the State will be out-of-pocket for withheld taxes it has never received from the employer. Accordingly, the Legislature has prescribed stringent protective measures in the form of liability for the tax and penalties to insure collection.

One such protective measure is Tax Law section 685(g) which penalizes those persons responsible for the withholding and paying over of such funds for willfully failing to so withhold or pay over. This section provides:

> "Willful failure to collect and pay over tax. - Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No addition to tax under subsections (b) or (e) shall be imposed for any offense to which this subsection applies. The tax commission shall have the power, in its discretion, to waive, reduce or compromise any penalty under this subsection." (Emphasis added.)

Tax Law section 685(n) defines persons subject to the 685(g) penalty as follows:

> "Person defined. - For purposes of subsections (g), (i), (o), (q) and (r), the term person includes an individual, corporation or partnership or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." (Emphasis added.)

This statutory scheme is designed to insure the collection by the State of the income taxes due it. While it does not relieve individual employees from all liability for the timely and proper payment of their taxes, it does reduce the State's exposure by placing separate responsibility for withholding on employers and individual personal responsibility on those persons responsible to see that income taxes are withheld and paid over to the State. The personal liability under section 685(g) is neither derivative of nor secondary to the employer's liability (Yellin v. New York State Tax Commn., 81 AD2d 196).

The issue before us in this case is whether petitioner's failure to pay the withholding taxes was willful. There is no evidence in the record before us, and the Administrative Law Judge did not find, that petitioner had actual knowledge that the withholding taxes were not paid when due; thus, this case is not within the realm of Levin v. Gallman (42 NY2d 32, 396 NYS2d 623) and Dorfman v. Chu (148 AD2d 917, 539 NYS2d 549). In each of these cases, it was decided that a knowing failure to pay taxes was willful, notwithstanding extenuating circumstances

surrounding the failure to pay. The Court of Appeals stated in Levin that the test of willfulness was whether the act of nonpayment was "consciously and voluntarily done" (Levin v. Gallman, supra, 396 NYS2d 623, 624).

Since petitioner did not have actual knowledge, the issue is whether his failure to know that taxes were not paid resulted from a reckless disregard for known or obvious risks which should be equated to actual knowledge (Matter of David B. Lyons, Tax Appeals Tribunal, June 3, 1988; Matter of Leopold Gallo, Tax Appeals Tribunal, September 9, 1988; Matter of Stephen G. Flax, Tax Appeals Tribunal, September 9, 1988).

The Administrative Law Judge found that it was unreasonable for the petitioner to believe that the payments he was making under the Deferred Payment Agreement were to satisfy current as well as past liabilities and that such belief constituted a reckless disregard of petitioner's responsibilities to see that taxes were paid.

We disagree with this conclusion and based on the record before us we reverse the determination of the Administrative Law Judge on the question of willfulness.

In the instant case we do not have a responsible officer who recklessly disregarded his corporate fiduciary responsibilities. The facts confirm that the petitioner took over handling the tax matters of FML in July 1981, and immediately visited the local office of the Department of Taxation and Finance in order to resolve FML's tax debts. Further, in that same month, petitioner started making payments by delivering $5,000.00 to the local office. The record before us also shows that for the next two years, including September 29, 1983, petitioner delivered checks for payment of sales taxes, corporation taxes and withholding taxes to the local district office, and starting December 2, 1983 forwarded checks directly to Albany for payment of withholding taxes.

The only Deferred Payment Agreement (dated December 7, 1981) submitted in evidence by the Division of Taxation, executed by the petitioner and a representative of the Division, was in the amount of $59,007.57 relating to sales tax.

A Division representative testified, when asked about the preparation of deferred payment agreements, that when he made out a Deferred Payment Agreement, it was taken exactly off the computer printout so at that point in time a taxpayer knew what he owed.[2]

Another Division representative testified, that during the period for which a taxpayer has entered in a Deferred Payment Agreement the Division requires the timely filing and full payment of current tax liabilities or he would be in default and that most often the taxpayer is asked to submit the current returns and payments to the local office, although that is not mandatory.[3]

It should be pointed out that from the time the petitioner assumed the responsibility for handling the tax matters to the time of signing the payment agreement on December 7, 1981, he had already made payments to the District Office totaling $28,799.01 with an additional amount of $5,983.03 being paid in the remaining days of 1981. The total payments made by petitioner to the District Office from July 1981 thru September 1983 amounted to $103,030.03 which exceeds the combined amount of the signed Deferred Payment Agreement ($59,007.57) and the liability asserted here ($34,202.22).

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[2]TESTIMONY-(Tr. p. 169):

Q. Did you show him the computer printout?
A. I can't testify that I did, no.
Q. Do you know if the officer who prepared the Deferred Payment Agreement showed him the computer printout?
A. I can't testify for somebody else, but let me say this, that "when I made out the Deferred Payment Agreement, it was taken exactly off the computer printout. So at that point in time he knew what he owed."
Q. At the time the Deferred Payment Agreement was entered into, Mr. Lenhard knew what he owed?
A. That is correct.

[3]TESTIMONY (Tr. p. 91):

Q. What is the Department's procedure regarding the payment of current tax liabilities during the period for which a Taxpayer has entered in a Deferred Payment Agreement?
A. The Department's procedure is that all current taxes must be timely filed and full paid or else the Deferred Payment Agreement would be defaulted, and most often we ask for the Taxpayer to submit the current returns and payments to us, but that's not mandatory.
Q. Are all the Compliance Agents in the Rochester District Office for the Department of Taxation familiar with the policy you just outlined?
A. I sure hope so.

It must be noted at this time that although the compliance agent testified as to what actions the Department takes when a taxpayer defaults and the terms of the Deferred Payment Agreement itself point out that failure to meet the conditions of the agreement (i.e., payment of current liabilities) will lead to default, the record is void of information relating to FML, Inc. ever being placed in default or of further enforcement action being taken against it while the petitioner was making monthly payments to the District Office.

The credible evidence before us confirms that it was petitioner who first approached the Division in an attempt to clear up the tax problems of FML, Inc. and it was petitioner who made payments to the District Office for corporation, sales and withholding taxes due from FML, Inc. Further, the Division, while stating the issues before the Administrative Law Judge, conceded to the receipt of withholding tax payments during 1981 amounting to $3,330.46. Finally, testimony by a Division representative confirmed that an additional $5,000.00 in withholding tax payments was made during 1981, but was credited against outstanding sales tax assessments.

The preceding leads us to the conclusion that it was reasonable for the petitioner to believe that the payments to the District Office were to satisfy current as well as past liabilities and that he was meeting his tax obligations under law.

Based on all of the above, we find that petitioner did not recklessly disregard his fiduciary responsibility and did not willfully fail to collect or pay over tax within the meaning of section 685(g) of the Tax Law.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, Michael Lenhard, is granted;

2. The determination of the Administrative Law Judge is reversed; and

3. The petition of Michael Lenhard is granted and the Notice of Deficiency issued on May 21, 1984 is cancelled.

DATED: Troy, New York
November 9, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner